GENERAL AIR FORCE COUNSEL

FRAUD FACTS

DEPUTY GENERAL COUNSEL (ACQUISITION) ***No. 6, October 1998***

This is the sixth edition of ***FRAUD FACTS***, a biannual newsletter from the Air Force Deputy General Counsel (Acquisition) (SAF/GCQ).

The purpose of this newsletter is to provide information and feedback to Acquisition Fraud Counsel (AFC) at all levels concerning the ongoing operation of the Air Force's Procurement Fraud Remedies Program.

COs CAN'T RELATE

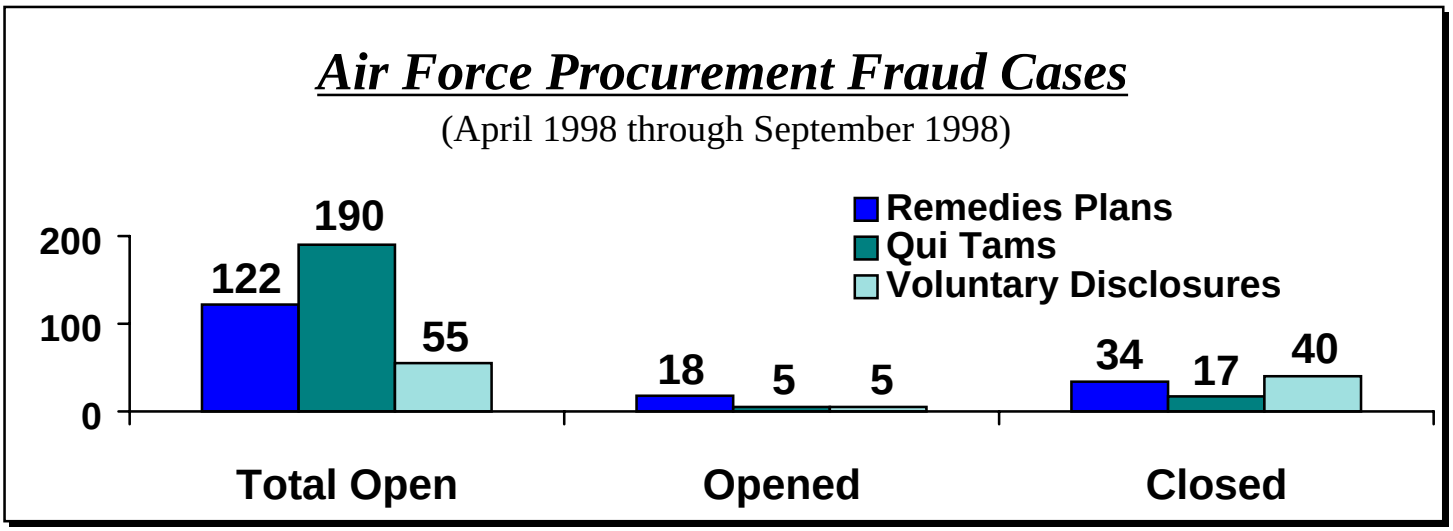
An administrative contracting officer (ACO) can not be a qui tam relator according to the 9th Circuit. In a recent decision, U.S. ex rel. Biddle v. Stanford University, 147 F.3d 821 (9th Cir. 1998), the court determined that an ACO who discovers fraud in one of his contracts can not file a qui tam False Claims Act (FCA) case even if the Government declines to pursue the matter.

Biddle, an ACO, uncovered what he thought was overcharging of indirect costs by Stanford University. He reported his suspicions to superiors but the case was not pursued. Biddle went to the media where his allegations received extensive coverage from newspapers and the TV show 20/20. After a year of media exposure, Biddle filed his qui tam lawsuit.

The FCA states that a court shall not have jurisdiction over an action "based upon the public disclosure" of the allegations/transactions "unless the person bringing the action is an original source." 31 U.S.C. §§ 3730(e)(2)(A). Biddle argued that his suit was not "based upon" the public disclosure since he himself had made the disclosure to the media. The court rejected this argument. (*Note*: The 4th Circuit concluded otherwise in U.S. ex rel. Siller v. Becton Dickinson, 21 F.3d 1339 (1994) (for purposes of the FCA, "based upon" means "derived from.")).

Since Biddle's suit was "based upon" his public disclosure to the media, Biddle's case could only be heard if he was an "original source" of the information. 31 U.S.C. §§ 3730(e)(4)(A). An original source is defined as an individual with "direct and independent knowledge" of the wrongdoing and who "voluntarily provides the information to the Government before filing an action." 31 USC § 3730(e)(4)(B). The court concluded that Biddle—as an ACO—was required to report fraud so his disclosure could not be voluntary. Therefore, Biddle was not an "original source," and his case was properly dismissed.

Applying the test whether an employee's job included the requirement to disclose fraud, the 9th



Circuit had ruled in earlier cases that an internal government auditor could not be an "original source" but that a government attorney could be. *Quaere*: Does Executive Order 12674 (54 Fed. Reg. 15159) ("Employees shall disclose waste, fraud, abuse, and corruption to appropriate authorities.") prevent any executive branch employee from qualifying as a qui tam relator under the 9th Circuit's rationale?

PERSONA NON-GRATA

The Defense Acquisition Regulation Council has proposed a revision to DFARS 203.570, Employment Prohibitions on Persons Convicted of Fraud or Other DoD Contract-Related Felonies. DFARS 203.570 implements 10 U.S.C. § 2408 which imposes a criminal fine of up to $500,000 on contractors who hire people for certain positions within five years of that person's conviction for a felony involving a DoD contract.

The proposed rule would expand the list of prohibited positions to include those in "any other capacity with the authority to influence, advise, or control the decisions" of the company. Additionally, the proposed rule would allow the five-year prohibition to be extended by the agency head or designee.

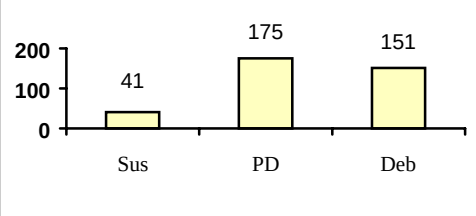
BITS 'n' PIECES FROM SAF/GCR

By William L. Finch

The suspension and debarment arena was bustling this year. There was good news and bad news in the federal circuits, and GCR's FY 98 statistics reflect a case increase of 85% over FY 97. The increase is a result of our continuing emphasis on pursuing fact-based debarments and sending that message to the field. As a result, agents and AFCs have been sending us cases earlier in the investigative process and cases for which they may have thought there was no remedy. This office does not have a dollar threshold and does not believe in a "no harm, no foul rule." If you have a problem performer and can document it, send us the case.

SUSPENSION & DEBARMENT STATS

The chart below shows Air Force suspensions, proposed debarments, and debarments during FY98. Of the Air Force's 192 suspension and debarment actions, 105 were based on facts other than an indictment or a conviction.



Case Happenings

Concerning the federal circuits, the Air Force won one in the Fourth Circuit and lost one in the Ninth.

First, on the theory that one should eat dessert first, is the case of Frequency Electronics, Inc. v. U.S. Department of the Air Force, 151 F.3d 1029 (4th Cir. 1998). [*Ed. note: we discussed the district court decision in* ***FRAUD FACTS***, April 1997.] Briefly, the case involved an indictment returned on 17 November 1993 by a federal grand jury in the Eastern District of New York which alleged that Frequency Electronics, Inc. (FEI) and four of its senior executives engaged in a conspiracy to defraud the Government in its submission of a termination claim. On 13 December 1993, the Air Force suspended FEI and the four executives. The suspension remained in effect through December 1996, and in early 1997, FEI sued the Air Force on three grounds: (1) since debarments "generally… should not exceed 3 years" per FAR 9.406-4(a)(1), no suspension could last more than three years as a matter of law; (2) the length of the suspension rendered it punitive; (3) GCR's decision to maintain the suspension beyond three years was arbitrary and

capricious. All three grounds were rejected in the District Court and again in the Fourth Circuit.

On 19 June 1998, pursuant to its guilty plea, FEI was convicted of a single count of making a false statement in violation of 18 U.S.C. § 1001 and was sentenced to pay a $400,000 fine and restitution of $1,100,000. On 9 July 1998, the Air Force proposed FEI for debarment and terminated the suspension of the four executives on July 13th. After reviewing FEI's submissions and much classified information, the Air Force debarred FEI for a period of five years, which period began to run from the date FEI was first suspended.

Although the 4th Circuit's decision is unpublished, it is well worth reading as it contains a wealth of research on the due process issues surrounding agency debarment and suspension authority.

Now, the bad news -- gotta eat those brussel sprouts eventually -- Sameena, Inc., et al v. U.S. Air Force, 147 F.3d 1148 (9th Cir. 1998). In May 1996, Sameena and several of its principals were proposed for debarment. One of those individuals, Zulfiqar Eqbal, was proposed for debarment as an affiliate because as its vice president he could exercise control over the company. The evidence supporting that conclusion was a bank signature card which so identified him. In its replies to the proposed debarment, Sameena provided a letter from that bank which indicated that Eqbal was not a corporate vice president. The Air Force debarred him and Sameena sued. According to the court, this evidence raised a genuine dispute of a fact material to the debarment requiring the Air Force to conduct a fact-finding hearing to determine the true facts of Eqbal's status. The court reversed the district court's and ordered the Air Force to conduct a fact-finding hearing.

Now for the rest of the story. Not only is this decision applicable to a very narrow set of facts, on 27 August 1998, Zulfiqar was indicted for bank fraud. He has since fled the United States and a federal arrest warrant awaits his return. On 30 September 1998, based on the indictment and the web of affiliations, the Air Force suspended all of the original parties. As yet, we have received no reply to the notices of suspension. See, those Brussel Sprouts weren't that bad after all.

ANOTHER DECLINED QUI TAM RECOVERY

In the last issue of ***FRAUD FACTS***, we told you about a large verdict in U.S. ex rel. Boivert v. FMC Corp., a case in which the Government had declined to intervene. There's been another large recovery in a declined qui tam case--a $26.36 million settlement in U.S. ex rel. Colunga v. Hercules, Inc., which was approved by the court on 7 July 1998. In the Hercules case, the relator alleged problems with the quality control of Hercules' rocket motor manufacturing operation. The $26.36 million FCA settlement was divided between the government and the relator, as mandated by the FCA. The relator received the maximum amount permitted by the statute, 30% ($7.91 million), and $18.45 million went to the Government.

Because of these recent successes in declined qui tam cases, we may see more relators willing to proceed even if the Government declines to intervene. This may mean more funds recovered for the Government, but it may also mean more work for AFCs and program personnel. In the Hercules case, the Air Force spent considerable time reviewing and responding to requests for documents and interviews in connection with the litigation. Remember--a case ain't over 'til the dismissal order (not the declination notice) is filed!

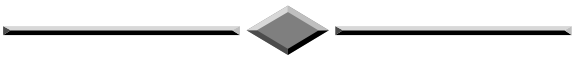
RULES FOR DAMAGES

Proving that a false claim has been made is only half the battle—proving damages is the other half. Under 31 U.S.C. § 3729(a), a person who makes a false claim is liable for "a civil penalty of not less than $5,000 and not more than $10,000, plus 3 times the amount of damages which the Government sustains." In order to recover FCA damages, the Government must prove that it

sustained an actual loss. If the contractor submitted a false claim in delivering goods of the same quality as specified in the contract, the Government is not entitled to damages; however, the Government is still entitled to penalties.

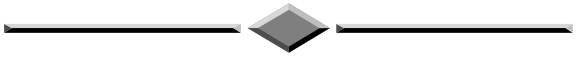
The normal measure of damages is the difference in the market value of the goods received and the goods contracted for. If it isn't possible to prove loss of value, then an alternate measure would be the cost to remedy the defect. The caveat to this alternate measure is that the cost to remedy is not clearly disproportionate to the probable loss in value. However, in a construction setting, the cost of remedying defects is not disproportionate if the defects significantly affect the integrity of the structure.

These rules were recently stated and applied in Commercial Contractors, Inc., 154 F.3d 1357 (Fed. Cir. 1998). The court upheld an award of substantial damages to remedy defects caused by improper backfill material because the structural integrity of the flood control channel was affected. However, the court overturned a considerable damages award to remedy alleged defects in concrete because the Government failed to prove that the structural integrity of the concrete was affected; however, the Government was still entitled to a $10,000 penalty.



A LONG-FOUGHT VICTORY

After litigating for three years, the Government has come to a successful resolution of its FCA case against Dowty Woodville Polymer. A former employee of the company, Jeffrey Thistlethwaite, brought a qui tam action in 1994, alleging that the company engaged in defective pricing on contracts for F-111 and B-1B wing seals. In 1995, the Government intervened in the action, and the case was settled on 29 July 1998 for $12.35 million. Kudos to Assistant United States Attorneys Gideon Schor, Jonathan Willens, and Amy Benjamin for negotiating this favorable settlement, and thanks to Ken Kitzmiller and others at Tinker AFB for doing the research to return the Air Force's share of the recovery to the proper accounts. It was discovered that some of the recovery can be returned to "no year" accounts, thus permitting the Air Force to use those funds!

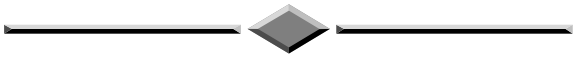


CHANGES AT SAF/GCQ

Times, they are a-changing . . . in SAF/GCQ. Within a couple of months, two of the players at the Coordination of Procurement Fraud Remedies Program will be different. Kathy Burke's term in GCQ will be completed on 30 October, and she will be moving to North Carolina in search of new opportunities. Rick Sofield has been offered a position doing fraud work at the Department of Justice and will be leaving on 7 December.

Replacing Kathy is Warren Leishman who came on board 28 October. Warren is a graduate of the University of Utah College of Law and Brigham Young University; he is a member of the Utah bar.

SAF/GCQ is actively looking for another candidate to join the fraud team.



WHO'S WHO @ SAF/GCQ

The Procurement Fraud Remedies Program attorneys at SAF/GCQ are:

John A. Dodds
DoddsJ@af.pentagon.mil
Richard C. Sofield
SofieldR@af.pentagon.mil
Warren Leishman
warren.leishman@pentagon.af.mil

Tel: DSN 227-3900 or (703) 697-3900
Fax: DSN 227-3796 or (703) 697-3796